

REPORT OF EXAMINATION
OF THE
FIRST AMERICAN HOME BUYERS
PROTECTION CORPORATION
AS OF
DECEMBER 31, 2003

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Los Angeles, California
June 4, 2004

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

FIRST AMERICAN HOME BUYERS PROTECTION CORPORATION

(hereinafter also referred to as the Company) at the Company's statutory home office and main administrative office, located at 7833 Haskell Avenue, Van Nuys, California 91406.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2000. This examination covers the period from January 1, 2001 through December 31, 2003.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: company history; corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; and sales and advertising.

SUBSEQUENT EVENTS

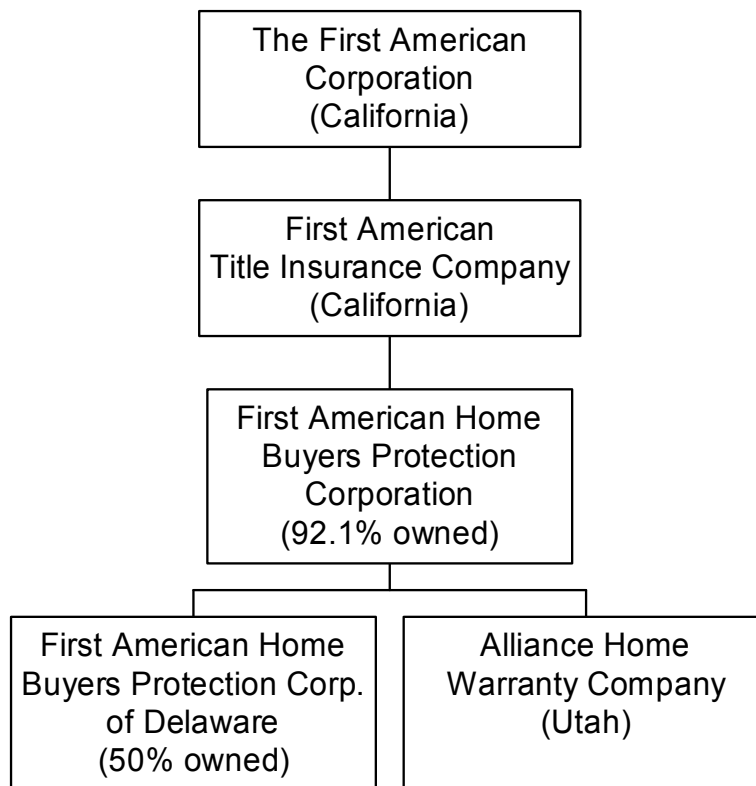
In addition to the \$27.1 million in unsecured loans made to the Company's ultimate parent, The First American Corporation (FAFCO), a California entity, the Company has been approved by the California Department of Insurance to lend an additional \$40 million in unsecured loans to FAFCO in

2004, followed by another \$10 million in 2005 if the Company's surplus rises above \$110 million in 2004.

MANAGEMENT AND CONTROL

The Company is a subsidiary of First American Title Insurance Company, which owns 92.1% of the outstanding stock of the Company. The remaining stock is owned by two members of the management team, Martin R. Wool and Daniel T. Langston, and one retired member, Philip B. Branson.

The following abridged organizational chart, which is limited to the Company's parent along with its subsidiary insurance companies, depicts the Company's relationship within the holding company system:



(*) all ownership is 100% unless otherwise noted

Management of the Company is vested in a seven-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2003 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Martin R. Wool Bell Canyon, California	Chairman of the Board, President and Chief Executive Officer
Daniel T. Langston Camarillo, California	Executive Vice President and Chief Operations Officer
Debra S. Nagasawa Agoura Hills, California	Vice President – Administration and Secretary
Carla M. Roupe Canoga Park, California	Vice President – Controller and Treasurer
Maggi E. Havas Valencia, California	Vice President – National Sales and Marketing Manager
Kathy Goldsmith Malibu, California	Vice President – Divisional Sales Manager
Denise Magnoli San Jose, California	Vice President – Divisional Sales Manager

Principal Officers

<u>Name</u>	<u>Title</u>
Martin R. Wool	President and Chief Executive Officer
Daniel T. Langston	Executive Vice President and Chief Operations Officer
Debra S. Nagasawa	Vice President – Administration and Secretary
Carla M. Roupe	Vice President – Controller and Treasurer
Maggi E. Havas	Vice President – National Sales and Marketing Manager
Kathy Goldsmith	Vice President – Divisional Sales Manager
Denise Magnoli	Vice President – Divisional Sales Manager

Management Agreements

Tax Allocation Agreement: The Company and its affiliates are parties to a tax sharing agreement dated December 15, 1994 with The First American Corporation (FAFCO), its ultimate parent. FAFCO will prepare, file and pay consolidated federal income taxes due. Allocation of federal income taxes is based on separate return calculations. Any differences between the sum of the separate return tax liabilities, the separate return tax refunds, and the consolidated federal income tax liability are to be allocated to the members. In the event that FAFCO has an overall net operating loss (NOL), the NOL will be allocated among the members of the return. The benefit shall be allocated among the members who incurred the NOL. Payment of the benefit will be made by FAFCO by check as soon as possible after receipt of any refund from the IRS.

Although the Company derives home protection fee income from its wholly-owned subsidiary, Alliance Home Warranty Company, a Utah corporation, there is no written agreement in effect governing management or claims administration. It is recommended that the Company execute a management agreement with Alliance Home Warranty Company and submit it the California Department of Insurance for approval.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2003, the Company was licensed to transact home protection business in the following states:

Alabama	Indiana	Nebraska	Pennsylvania
Alaska	Iowa	Nevada	South Carolina
Arizona	Kansas	New Jersey	South Dakota
Arkansas	Kentucky	New Mexico	Tennessee
California	Louisiana	New York	Texas
Colorado	Michigan	North Carolina	Utah
Connecticut	Minnesota	North Dakota	Vermont
Florida	Mississippi	Ohio	Washington
Georgia	Missouri	Oklahoma	Wisconsin
Idaho	Montana	Oregon	Wyoming
Illinois			

In 2004, the Company became licensed in Hawaii and Massachusetts; licensure in New Hampshire is pending.

In 2003, the Company wrote \$125.5 million in direct premiums. Of the direct premiums written, \$67.3 million (53.7%) was written in California, \$28.2 million (22.4%) was written in Texas, \$12.5 million (10.0%) was written in Arizona, and \$17.5 million (13.9%) was written in the remaining states.

The Company issues home protection contracts to owners of single-family homes, multiple unit buildings of up to four units, and mobile homes. The Company is obligated to repair or replace covered systems and appliances that become inoperable due to normal wear and tear during the term of a contract. The following are covered within the basic provisions of the contract: plumbing, electrical and heating systems, water heaters, dishwashers, garbage disposals, garage door openers, ovens, cooktops, built-in microwave ovens, built-in trash compactors, ceiling and exhaust fans, central vacuum systems, and pest control. In addition, the Company offers optional coverage for an additional charge for air conditioning systems, pool and spa equipment, refrigerators, limited leak roof repair, well pump systems, and one-time septic tank pumping. The Company writes a limited number of contracts with two-year roof leak protection for HUD properties. The contractholder is required to pay a service charge of \$45 for each separate trade call.

The Company's business is written through its own employees, as it does not utilize agents. In addition to its corporate office, the Company maintains a consumer sales office in Santa Rosa, California and call centers in Odessa, Texas and North Hills, California.

REINSURANCE

The Company has no reinsurance assumed or ceded.

ACCOUNTS AND RECORDS

During the course of the examination, a review was made of the Company's general controls over its information systems. As a result of the review, weaknesses were noted in areas such as program change controls, system and program development, logical and physical security, and testing of backup equipment. The weaknesses noted were presented to the Company along with recommendations to strengthen its controls. It is recommended that the Company evaluate the recommendations and make appropriate changes to strengthen its information system controls.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2003

Underwriting and Investment Exhibit for the Year Ended December 31, 2003

Reconciliation of Surplus as Regards Contractholders
from December 31, 2000 through December 31, 2003

Statement of Financial Condition
as of December 31, 2003

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$114,806,969	\$	\$114,806,969	
Real estate, less encumbrances	4,766,833		4,766,833	
Mortgage loans on real estate	1,450,000		1,450,000	
Cash on deposit	18,797,758		18,797,758	
Other invested assets	3,675,000	3,675,000	0	
Home protection contract fees receivable	6,345,828	4,669,576	1,676,252	
Receivable from parent, subsidiaries, and affiliates	59,952		59,952	
Federal income tax recoverable	91,413		91,413	
Electronic data processing equipment	1,158,986	763,569	395,417	
Interest, dividends, and real estate income due and accrued	1,707,124		1,707,124	
Equipment, furniture, and supplies	879,439	879,439	0	
Deferred acquisition cost	9,631,869	9,631,869	0	
Other assets	<u>27,575,289</u>	<u>438,437</u>	<u>27,136,852</u>	
Total assets	<u>\$190,946,460</u>	<u>\$ 20,057,890</u>	<u>\$170,888,570</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Claims adjusted and unpaid or in process of adjustment			\$ 6,496,707	(1)
Claims service expense			175,000	
Other expenses			6,867,549	
Taxes, licenses, and fees (excluding federal taxes)			778,234	
Unearned home protection contract fees			53,228,122	
Deposits held – escheat			<u>193,586</u>	
Total liabilities			67,739,198	
Common capital stock		\$ 1,947,700		
Gross paid-in and contributed surplus		1,480,500		
Unassigned funds (surplus)		<u>99,721,172</u>		
Surplus as regards contractholders			<u>103,149,372</u>	
Total liabilities, surplus and other funds			<u>\$170,888,570</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2003

Statement of Income

Underwriting Income

Home protection contract fees earned		\$ 116,788,038
Deductions:		
Claims incurred	\$ 55,185,426	
Claims service expense incurred	10,144,130	
Other expenses incurred	<u>31,624,454</u>	
Total underwriting deductions		<u>96,954,010</u>
Net underwriting gain		19,834,028

Investment Income

Net investment income earned	<u>\$ 6,911,856</u>	
Net investment gain		<u>6,911,856</u>
Net income before federal income taxes		26,745,884
Federal income taxes incurred		<u>9,881,051</u>
Net income		<u>\$ 16,864,833</u>

Capital and Surplus Account

Surplus as regards contractholders, December 31, 2002		\$ 88,374,801
Net income	\$ 16,864,833	
Change in nonadmitted assets	<u>(2,090,262)</u>	
Change in surplus as regards contractholders for the year		<u>14,774,571</u>
Surplus as regards contractholders, December 31, 2003		<u>\$103,149,372</u>

Reconciliation of Surplus as Regards Contractholders
from December 31, 2000 through December 31, 2003

Surplus as regards contractholders, December 31, 2000, per Examination			\$ 67,880,070
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$40,787,753	\$	
Change in non-admitted assets		5,567,563	
Change in treasury stock	49,112		
Totals	<u>\$40,836,865</u>	<u>\$ 5,567,563</u>	
Net increase in surplus as regards contractholders			<u>35,269,302</u>
Surplus as regards contractholders, December 31, 2003, per Examination			<u>\$103,149,372</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Claims Adjusted and Unpaid or in Process of Adjustment

Home warranty claims generally are paid within a short period of time after the repairs have been made. Based on a review of loss payments, subsequent to the date of this examination, the Company's estimate of \$6,496,707 for claims unpaid was determined to be reasonably stated and has been accepted for purposes of this examination report.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Management Agreements (Page 4): It is recommended that the Company execute a management agreement with its subsidiary, Alliance Home Warranty Company, and submit it to the California Department of Insurance for approval.

Accounts and Records (Page 5): It is recommended that the Company review its information systems and make appropriate changes to strengthen internal controls.

Previous Report of Examination

Territory and Plan of Operation (Page 4): It was recommended that the Company include language in all its home protection contracts in accordance with California Insurance Code (CIC) Section 12762(a)(4)(E). The Company is currently in compliance with CIC Section 12762(a)(4)(E).

Federal Income Taxes (Page 11): It was recommended that the Company reclassify a negative liability for federal income tax due as an asset. The Company currently presents all receivables as assets.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

David Gilman, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California